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ARIZONA CORPORATION COMMISSION
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Request for Comments
on
Electric Industry Restructuring

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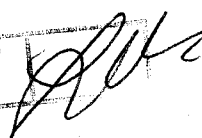
Docket No. U-0000-95-165

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COMMENTS
OF
ARIZONA ELECTRIC POWER COOPERATIVE, INC.

Arizona Corporation Commission
DOCKETED

JUN 28 1996

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I. INTRODUCTION

The electric industry is on the threshold of major, irrevocable changes which will transform the industry from one of government-sanctioned regulation, both state and federal, to an industry that will be part deregulated and part driven by competitive forces. The effects of this transformation will flow from both Federal initiatives involving wholesale power and transmission services and state initiatives affecting services to end-use (i.e., retail) customers. This transformation is similar in many respects to transformations which have occurred in other previously heavily regulated industries such as airlines, natural gas, and telecommunications.

The stakeholders in this electric industry reformation are many. They include traditional (investor-owned, cooperatively-owned, and municipally-owned) utility systems, utility system owners (including stockholders, member-owners, and the public), non-traditional suppliers (e.g., qualifying facilities ("QFs"), small power producers ("SPPs"), independent power producers ("IPPs"), non-utility generators ("NUGs"), exempt wholesale generators ("EWGs"), marketers, and brokers), wholesale ratepayers, retail ratepayers, state regulators, and federal regulators. The interests of these various stakeholders are diverse and often in conflict. Arizona Electric Power Cooperative, Inc. ("AEP CO") supports the Arizona Corporation Commission ("ACC" or "Commission") efforts to methodically investigate this industry reformation with the objective of proceeding in accordance with the overall public interest, which considers and balances the competing interests of the many constituencies affected by a new electric marketplace which fosters competition.

The Commission has at least two option paths which it could elect to follow. Option 1 would be to function much like a business entrepreneur which seeks to operate on the cutting edge of

innovation in seeking to shape the destiny of an industry. Individuals and entities which follow this path take greater risks, are willing to experiment, and proceed "to market" to be one of the first to offer a product or service, often in anticipation of being perceived as the industry leader and establishing market share. Option 2 is a path followed by other individuals and firms which are more marketing oriented and less technologically innovative. These players study the marketplace, better understand the needs of the marketplace, and develop strategies to respond accordingly by learning from and improving upon the first generation products and services offered by the innovators.

AEPCO perceives that the Commission has elected to follow Option 2. Rather than seeking to set the national standard for the electric industry as a whole at the retail level, the Commission is moving cautiously to gather information, understand as much as possible about the dynamics of the changes taking place, study and evaluate the actions of other regulatory bodies, and prudently develop a logical course of action which provides for an orderly transition and balances the various constituencies' interests. AEPCO supports the Commission's approach to avoid being swept into hasty action which benefits only a select few of the constituent interests in this complex process.

Change for the sake of change, while not always bad, can be very unpredictable. AEPCO supports voluntary pilot project experimentation because of the opportunity to study the effects of change without the risks of full-scale implementation of restructuring of the electric industry in Arizona. This approach is discussed in more detail in Section VII., below. Only through a studied approach can the Commission, in AEPCO's opinion, properly consider and meet the general objectives stated in its request for comments, which objectives AEPCO supports.

II. DESCRIPTION OF AEPCO AND ITS MEMBERS

AEPCO, its cooperative distribution system member-owners, and their retail-customer member-owners constitute one of the principal constituencies to be affected by any electric industry restructuring initiatives undertaken by the Commission. The interests of AEPCO, its distribution cooperative members, and their retail members are closely aligned, unlike those of other suppliers and consumers, given their unique owner-customer relationship. This unique relationship, which is described in detail below, is built on several critical concepts which could be adversely impacted by various restructuring initiatives.

AEPCO is a not-for-profit, generation and transmission cooperative headquartered in Arizona and delivering power in Arizona, New Mexico and California. AEPCO is owned by its six not-for-profit distribution cooperative members which it serves: Anza Electric Cooperative, Inc. (California); Duncan Valley Electric Cooperative, Inc. (Arizona and New Mexico); Graham County Electric Cooperative, Inc.; Mohave Electric Cooperative, Inc.; Sulphur Springs Valley Electric Cooperative, Inc.; and Trico Electric Cooperative, Inc. AEPCO, which supplies these member-owners' total power requirements pursuant to long-term power supply contracts, was created by its member-owners to produce reasonably priced, reliable electric power to them for their members. This primary purpose has not changed, since AEPCO's "ratepayers" are those same member-owners.

AEPCO is governed by a board of directors comprised of representatives from each of its member-owners. In turn, the distribution cooperative member-owners are governed by a separate board of directors elected by the member-owner consumers of each of those distribution systems. Under this ownership and governance relationship, both the G&T and distribution cooperative

suppliers are owned and controlled by the consumers they serve, and both have an ultimate obligation to serve to these end-use retail member consumers.

AEPCO's distribution cooperative member-owners serve more than 91,000 retail customer members in a combined service area of some 30,000 square miles. These distribution cooperatives, which are also owned by these customer members, have a utility's obligation to serve their members in accordance with the statutes and regulations applicable to their enterprises.

In addition to its distribution cooperative members, AEPCO also sells power to the City of Mesa, Arizona and the Salt River Project Agricultural Improvement and Power District ("SRP"), both of whom are partial requirements (Class B and Class C) members. These sales, like those made to its member-owners, are made pursuant to negotiated, long-term power contracts.

AEPCO is financed primarily with Rural Utilities Service ("RUS")¹ direct loans and RUS-guaranteed loans through the Federal Financial Bank ("FFB"). As principal lender, RUS has a financing agreement, including lien, associated with all of AEPCO's property. AEPCO also has other forms of financing (e.g., pollution control bonds, solid waste disposal bonds, and other debt) which are subject to lien accommodations by RUS. As a result of this financing relationship with RUS, AEPCO is subject to the federal regulatory oversight of RUS. This financing arrangement is premised on the requirement that AEPCO's members enter into long-term power contracts with AEPCO with rates set sufficient to pay RUS debt. Continued access to this beneficial financing through RUS is contingent upon this G&T/distribution system contractual relationship which underpins it.

¹RUS was formerly the Rural Electrification Administration.

AEPCO's distribution members are also financed primarily by RUS loans. The availability of this financing is predicated, in part, on the expectations of the distribution cooperatives and RUS that service to the distribution cooperatives member consumers will continue, be adequate to service the debt, and will provide reasonably priced, reliable electric service to all such customer members.

As can be seen from this description, AEPCO and its members have bonded together for a common purpose, have secured financing based upon that common purpose and relationship, and remain viable as a result of this unique relationship. Many of the structural changes being contemplated in general and by the Commission specifically could have a substantial impact on the above-described relationship, including the underpinning financing. AEPCO is sure that the Commission is well aware of this unique relationship, but feels compelled to emphasize it in the context of the retail competition/industry restructuring debate so that the Commission views afresh all of the facts which must be weighed in selecting a path consistent with the public interest.

III. SUMMARY OF RECOMMENDATIONS

AEPCO supports the Commission's deliberate, measured approach to assessing whether retail competition is in the public interest in Arizona and, if so, to what extent electric industry restructuring is required to implement a given retail competition plan. AEPCO believes that the first question the Commission should ask in this process is whether there is a real problem in Arizona that requires an immediate fix. AEPCO concludes that Arizona is not suffering from the same extremely high costs of power faced by ratepayers in other parts of the country (e.g., California and the Northeast), which high costs are providing the impetus for retail competition. Moreover, the greatest potential beneficiaries of retail competition initiatives are a relatively few large industrial and commercial customers that have the ability to take advantage of the current bulk

power market being driven in the short run by surplus capacity and energy and for the foreseeable future by marginal costs that are less than average embedded costs. The changes being urged should do more than just provide these few with cheaper power; instead, they should provide a demonstrably better public policy than the current system. Consequently, AEPCO submits that the Commission should not act precipitously at the urging of any such narrow, self-interest constituency, but rather should weigh its options and proceed in a fashion that will truly benefit the public interest.

AEPCO urges the studied approach to any structural shift from regulation to a partially or totally competition-driven environment for numerous reasons. First, the potential long-term effects are overwhelming. Second, the effects of wholesale bulk power competition will only become known as the full effects of open access transmission develop with the implementation of the Federal Energy Regulatory Commission's policies under Order No. 888. The potential benefits of such competition should be allowed to take hold before deregulation or relaxed regulation at retail should be mandated.

Third, many of the benefits of retail competition can be achievable for those entities (primarily large commercial/industrial customers) through flexible contracts, performance-based ratemaking, voluntary single-utility based "pilot" programs, and other measures which do not require a major overhaul of existing statutes, rules and regulations. Fourth, the cost and technological viability of metering and communication systems may, in the immediate future, severely limit the ability of small users to access alternative suppliers. Fifth, a great deal can be learned from what others are doing across the industry as some (e.g., California) try to implement full scale retail competition and others conduct pilot programs to gather data and assess the impact of changes.

The Commission also needs to address the numerous legal issues identified in Phase I of its investigation. Although none of these legal issues is perceived by AEPCO at this time as an absolute barrier to retail competition or restructuring, they reflect significant institutional/regulatory issues which must be resolved before full-scale implementation can proceed. Absent such determinations, it is difficult to perceive how the Commission could knowledgeably evaluate whether to proceed and, if so, how.

There are special circumstances which the Commission should recognize as it considers what course of action to take. First, certificated utilities have operated (i.e., planned and constructed facilities and provided services) on an expectation of serving customers in a given area and in return, have assumed a responsibility to serve those areas. They have relied on this regulatory compact and any shift to retail competition must provide for a transition which allows recovery of prudently incurred stranded costs.

The unique contractual, financing, and ownership relationship among AEPCO, a generation and transmission rural electric cooperative, its distribution member-owners and those owners' member-owner retail customers closely binds those constituencies together for a common good. Disturbing any element of this relationship could cause the demise of that relationship and those systems, and there are no shareholders to absorb any adverse results, only the member-customer owners. This must also be considered in the context of the competitive disadvantage of the cooperatives in Arizona which serve the electric industry's less desirable (e.g. lower density and smaller consumer) areas. The vulnerability of these systems to the potential adverse effects of a radical shift to retail competition should be carefully considered.

Before proceeding with full-scale implementation of retail competition, the Commission should first consider voluntary single-utility based pilot programs to study the effects and consider operational problems. If such voluntary programs do not provide solutions, are not effective or the results inconclusive, the Commission can elect to implement "pilot" programs for further analysis prior to any major regulatory changes. Informed decision making is imperative in AEPCO's view. The Commission should resist theoretical competition rhetoric in favor of accepting well-documented analyses which demonstrate that retail competition is in the public interest.

Although AEPCO is not recommending implementation of retail competition and/or restructuring at this time, it perceives the need for the Commission to establish a set of principles upon which to measure others' efforts and which will guide the analysis, deliberation, and any implementation of retail competition and industry restructuring in Arizona. Such core principles should include, at a minimum, the following concepts:

- Contractual relationships must be maintained (including, but not limited to, utility/end-user contracts, G&T/distribution cooperative all-requirements contracts, financing contracts which might otherwise be impaired, and other existing contractual relationships upon which either the supplier or purchaser has reasonably relied as to an expectation of future sales or purchases of power in the retail sector);
- There will be recognition and full recovery of legitimate, prudently incurred and verifiable stranded costs from those users creating such stranded costs as a result of retail competition (including recognition that loss of retail load by distribution cooperatives may create recoverable stranded costs at the G&T supplier level);

- It is in the public interest to avoid unnecessary and uneconomic duplication of distribution facilities, and therefore local distribution suppliers should retain their vested property rights associated with certificates of convenience and necessity;
- Sham transactions to convert retail load to wholesale service to circumvent compliance with retail regulation (including retail competition and restructuring) will be rejected;
- Notwithstanding retail competition, the costs of renewable programs, demand-side management programs, and energy conservation programs mandated by the Commission through its integrated resource planning objectives should be borne equitably by all consumers, irrespective of their ability to secure alternative power supply arrangements;
- All societal costs associated with the transition from regulation to retail competition should be borne by consumers in accordance with their contribution to those costs (e.g., adverse environmental impacts as a result of retail competition should be borne by those creating such costs by accessing alternative power supply resources); and
- Any incremental costs attributable to the exercise of power supply alternatives as a result of retail competition should be borne by the beneficiary(ies) of the alternative power supply arrangements (e.g., if transmission and other facilities upgrades are required to accommodate the import of power from alternative power suppliers, the user of the alternative power should be responsible for such associated costs).
- A universal service fund should be established to ensure that rural consumers continue to have access to affordable essential electric service through their existing

organizational structures on a basis that is competitive with the rates charged to consumers in more attractive, lower cost-of-service areas.

IV. INDUSTRY STRUCTURE AND LEVELS OF COMPETITION

Before proceeding with discussion of recommendations regarding retail competition and industry restructuring, it is helpful to establish a structural framework for the industry and for basic levels of competition as two basic points of reference. In so doing, AEPCO does not believe it is necessary, and therefore does not intend, to engage in a theoretical analysis of competition, looking at factors of production and delivery and addressing such matters as geographic and product markets. Such theoretical details, we suggest, are best left for academic consideration and assessment of discriminatory and anti-competitive practices. At this juncture, a more basic set of principles is satisfactory to focus initially on recommending how the Commission should respond as a result of and as an inducement to competition.

Historically, most power transactions, both wholesale and retail, reflected bundled services. Wholesale transactions generally have been comprised of the production (i.e., generation) and transmission functions. Occasionally, wholesale transactions also embodied a small component of the distribution function, i.e. sales to small town utility systems. Wholesale sales involved inter-utility transactions. The preponderance of such wholesale sales, which still represent a small percentage of total power sales in the industry, have been regulated by the Federal Energy Regulatory Commission ("FERC"). A limited sector of this wholesale bulk power market has been regulated at the state level (e.g., in Arizona), and some wholesale transactions are not regulated at all.

There are two prominent reasons for the limited amount of wholesale power transactions. One, historically utilities have planned, constructed, and operated their own facilities to serve their firm load commitments, and have engaged in inter-utility transactions more from a coordination perspective than a long-term power supply perspective. Two, until the passage of the Energy Policy Act of 1992 ("EPAct") and the issuance of FERC Order No. 888², access to transmission facilities was primarily voluntary (i.e., a public utility owning transmission facilities could not be compelled to wheel power for others except under limited circumstances).

The production or generation component of bulk power has progressively become more fungible in recent years. QF and SPP resources were given special status under the Public Utility Regulatory Policies Act of 1978 ("PURPA"), including a requirement either to purchase such power at avoided cost or to transmit such power to another purchaser. In the early 1980's, FERC began experimenting with relaxed regulation first with the Southwest Bulk Power Marketing Experiment and then with its successor the Western System Power Pool. These arrangements focused primarily on short-term bulk power transactions, with mandatory transmission access in the former and monitoring of the latter to ensure against denial of transmission access.

FERC further expanded open-access transmission while relaxing the regulation of power sales in the late 1980's. Open-access transmission became mandatory as a condition of FERC-approval of mergers. Also, in return for granting market-based pricing of wholesale power sales, FERC conditioned such sales on the implementation by the seller of non-discriminatory, open-access transmission tariffs for use by competitors. Passage of the EPAct broadened the FERC's authority

²Promotion Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities, Docket No. RM95-8-000, and Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Docket No. RM94-7-000, Order No. 888 (April 24, 1996).

to order transmission access upon application to the Commission. Not only were public utilities subject to this initiative, the EPAct created a new category of entities known as "transmitting utilities" which, with few exceptions, included any entities owning transmission facilities. This authority broadened access to the transmission grid for both sellers and purchasers to access alternative markets and resources.

Order No. 888, recently issued by the FERC, is intended to remove the last barriers to transmission access by requiring all public utilities to file open-access transmission tariffs which contain, at a minimum, certain pro forma terms and conditions of service. While this Order applies only to public utilities as defined under the Federal Power Act (principally investor-owned systems), it indirectly implicates transmission access across non-public utility systems (e.g., AEPCO and SRP) by incorporating a reciprocity requirement. The reciprocity rule requires a transmission user with transmission facilities to reciprocate by providing comparable transmission service to any transmission provider from which the transmission user receives service. Order No. 888 also requires functional unbundling of services so that a utility can no longer require a transmission user to purchase bundled generation and transmission services.

The principal effect of the above-noted events is the creation of a market fungible for production (i.e., power and/or energy) independent of transmission. Power can be purchased from multiple sources and sold into multiple markets and sub-markets without transmission barriers, other than technological and reliability constraints. Multiple wholesale buyers and sellers are functioning to create competitive bulk power markets. All utilities will now be able to participate in this fungible bulk power market to secure power to serve its load without necessarily having to commit to capital intensive investments as they have in the past.

Conversely, the transmission function historically has been, and will continue to be, a monopoly. It is impractical, uneconomic, environmentally unsound, and politically unacceptable to create duplicating transmission systems to compete with the existing transmission systems which are for the most part owned by individual utilities (i.e., there is limited joint ownership/joint use access). Order No. 888 recognizes this monopoly transmission environment and imposes open-access transmission obligations to avoid discriminatory and preferential access to such facilities. This is being done to further wholesale power competition and to increase economic efficiency in the operation of power supply resources.

The retail sector of the industry to a large extent stands in sharp contrast to the wholesale sector with regard to competition. Sales at the end-use level are still primarily bundled sales which include the production, transmission, and distribution functions associated with service to the various end-use customer classes. While wholesale customers historically and increasingly have had the ability to shop for alternative power suppliers, retail customers have not, but for very specific distinguishing reasons. Although utilities have been precluded from establishing exclusive service areas for wholesale transactions under Federal regulation, services provided to retail customers have long been predicated upon a clear regulatory compact predicated upon the principle that it is in the public interest to allow utilities an exclusive right to serve specific customers in return for the assumption by those utilities of the obligation to plan and serve those customers (including growth within an area generally recognized as being the service area for a given utility). Utilities serving retail customers directly (e.g., vertically integrated investor-owned utilities) and indirectly (e.g., G&T cooperatives) have made tremendous capital investments in facilities based upon this regulatory compact and the expectation of earning a fair rate of return on its investment.

This regulatory compact and the associated service commitments are now being challenged under the mantra of competition. With production cast as fungible, there are strong proponents of retail competition seeking to allow end-use customers to purchase power from alternative power suppliers. For the most part, these proponents recognize not only the monopoly nature of transmission facilities described above, but also the desirability of avoiding unnecessary and uneconomic duplication of the distribution function at the end-use level. In essence, the retail sector of the business is perceived to be headed toward a power function and a "wires" function, with the latter being subfunctionalized into transmission and distribution and the possibility of the same or different utilities providing these wires services. This structure theoretically would allow an end-user (or group of end-users) to shop for alternative power suppliers and have that power delivered over the transmitting utility's(ies') transmission and/or distribution facilities.

America's free enterprise system is founded on this concept of competition and choice. Workably competitive markets for goods and services are perceived to be superior to the regulation of those markets, including the prices for the goods and services. While AEPCO supports workable competition, it is mindful of the historical environment which gave rise to the regulation of monopolies such as electric utility systems. Reliable electric service has always been perceived as a public necessity. The capital-intensive nature of the industry and the impact of potential duplication on the cost of delivered power contributed to the regulatory environment existing today. The benefits of economies of scale and improved reliability were major contributors to consolidation within the electric industry.

What the Commission faces is a determination as to whether competition at the end-use level will be in the public interest more so than the regulated-industry environment that exists today. It

must make a judgment as to whether competition will increase customer choices, and whether it will lower the prices for services (below regulated prices) without sacrificing the reliability and universality of service. (AEPCO assumes here that no entity is espousing reduced reliability in exchange for lower prices, except in the context of gradients of service quality — e.g., interruptible or curtailable service versus firm service — with corresponding differentials in pricing.)

AEPCO asks the Commission to be cognizant of a number of critical components of this complex puzzle as it deliberates whether and, if so, how to facilitate retail competition. Surplus capacity and/or energy now exist and will continue to exist in various regions of the country into the next century. Given open-access transmission, the status of regional markets is as important, if not more important, than the status of supply and demand for individual utilities or a given state. As long as this surplus market exists, incremental costs will be substantially less than average embedded costs, especially given that the latter have been heavily impacted by uneconomic nuclear investment and the over-building of base-load capacity. Those who favor retail competition generally fall into one of three categories. The first is those suppliers with favorable cost structures and surplus capacity which desire to compete for the loads of their less fortunate competitors. The second is those suppliers with few large commercial and industrial customers to lose and much to gain. The third category of strong supporters are those consumers which are seeking to avoid the financial impact of past utility (and regulatory) decisions associated with the high embedded cost of existing resources. AEPCO's perception is that the strongest voices speaking for this third category are those large commercial and industrial users which because of size, sophistication, and resources can take advantage of bulk power competition, unlike the smaller, less sophisticated, and unorganized residential and small commercial consumers.

AEPCO is mindful of the experiences in the gas industry as it has undergone deregulation over the past decade. Without getting into an elaborate dissertation, it is AEPCO's perception that while gas deregulation has seemingly increased the availability of gas and reduced and stabilized the price of gas (especially in short-term markets), the bulk of the end-users of gas have seen no appreciable reduction in their costs of purchased gas from their local distribution companies. It is also AEPCO's perception that the major end-use beneficiaries of gas deregulation are the large commercial and industrial users (including utilities) which have the ability to shop and take advantage of lower-cost supplies and transportation access. AEPCO respectfully suggests that the Commission should be extremely sensitive to such potential effects of retail competition which result in a shifting of cost burden rather than an overall savings due to competition which accrues to the benefit of all end-use customers, not just a select few. Real net savings can only occur in the long-term, absent massive writeoffs or writedowns of existing assets, when the planning process is adjusted over time to absorb the lower marginal cost of new resources and reflect this beneficial effect in lower charges for services.

Technological advances are also affecting the cost of power within the electric industry. Advances in design are resulting in the ability to construct highly efficient combustion-turbine and combined-cycle resources with lower embedded capital costs and total operating costs which are often substantially less than average embedded costs upon which utilities traditionally have based rates. This decreasing cost environment is ripe for "cream skimming" where existing suppliers as well as new market entrants (e.g., IPPs, NUGs, EWGs, marketers, brokers, and aggregators) pick off the more attractive loads of other suppliers with high average embedded costs (and usually surplus capacity). Such opportunism creates the well recognized phenomenon of stranded costs

(sometimes referred to as transition costs to associate the cost with the effect of transition from a regulated environment to competition). It also results in higher rates to those remaining who must pick up the higher costs created by the departing load - whether operations and maintenance or fixed expenses - or see their local utilities in financial distress or bankruptcy. This is especially so for member owned rural electric cooperatives who have no "shareholders" to bear unrecovered stranded costs. The ultimate treatment of stranded costs will be the single biggest factor affecting any transformation to retail competition. Not only will the Commission's treatment of stranded costs affect the various customers of each regulated utility in Arizona, it will directly impact competition among all Arizona utilities and competition between those systems and utilities in neighboring states.³

Many entrants into the competitive bulk power marketplace are non-utilities in the sense that they do not operate utility systems, even though any wholesale sales they make are regulated by the FERC subject to relaxed regulation where market-based pricing is permitted. It has become apparent that many of these entities (e.g., some IPPs, NUGs, marketers, brokers and aggregators) cannot sell all of the components of service (e.g., reserves, load following services, reactive support and other ancillary services); rather they sell blocks of energy which must still be supported by required ancillary services to create reliable service. The same will be true when such entities enter the retail market under competition and seek to supply selected loads. They likely will not have a traditional utility obligation to serve, absent legislative or regulatory changes, thus leaving a void to be filled by the traditional supplier. These issues portend serious consequences with regard to

³What remains unclear after all of the debate to date on stranded costs is how there is a net benefit to end-users which must be responsible for both the market-based price of replacement resources and the cost of stranded investments.

reliability of service unless adequate safeguards can be implemented to protect end-users, both those taking service from such alternative suppliers and those remaining with the traditional supplier. AEPCO is not aware of any workable system which has been conceived to resolve these issues at the end-use level.

AEPCO also asks that the Commission also address the place of demand-side management (DSM) programs in a competitive market. AEPCO believes that DSM is beneficial to society and submits that striving for such societal benefit should continue. DSM programs in the electric utility industry must change as utilities transform themselves in a competitive environment. The challenge becomes finding a means to educate the public to the fact that DSM remains a viable alternative in its future power needs.

AEPCO believes that there exists today, and probably always will be, a market for energy efficiency. Therefore, in a free market utility industry many utilities will recognize the potential for increasing revenue by serving the energy efficiency market and act as energy service companies, providing energy efficient equipment and other energy efficiency measures in return for a share of the energy bill savings. In such instance, since the utility would pay the initial costs and the customer's energy bills would be reduced immediately, even low income residential customers would be able to avail themselves of this service without regulatory intervention.

Further, the ultimate role of renewable resources such as solar or wind power is unknown in a free marketplace. The initial costs for such renewable resources are typically much larger than for conventional resources. Nevertheless, renewable resources provide societal benefits that exceed their costs. Therefore, if support for renewable resources is to survive in a competitive environment, a method to reduce or eliminate their initial cost disadvantage must be found.

Regardless of what mechanisms the Commission might consider adopting to implement competition, the potential long-term effects are overwhelming. As options are considered, AEPCO simply asks that all the many competing factors and constituent interests be considered and balanced in reaching a decision. This includes the current competitive structure of the industry and the high cost of any transition to a more competitive environment. AEPCO respectfully suggests that all of the answers are not clear, as will be noted in more detail below, and therefore, caution and deliberateness are essential. It is better to thoroughly analyze issues, learn from the experiences of others, and even to conduct experiments in Arizona aimed at evaluating actual responses to competition in lieu of relying on academic theories.

V. INDUSTRY OVERVIEW OF RESTRUCTURING INITIATIVES

A. **Federal Initiatives.** By far, the single most significant activity at the federal level regarding restructuring and competition in the electric industry is FERC's issuance of Order No. 888. The effects of that Order as to the competitive structure for power and transmission services in the bulk power market is described in some detail in Section IV, above. The purpose here is to discuss the implications of this initiative for the industry in general, and the likely spill-over effect within the various states, and not to thoroughly investigate the implications of Order No. 888 in all its facets. AEPCO's comments focus on the potential benefits within the industry and the uncertainties between the state and Federal roles which continue to remain somewhat amorphous, thus contributing to uncertainty as to how to proceed at the state jurisdictional level.

Because of the open-access transmission environment created by Order No. 888 (if sustained on appeal, which is likely), virtually every utility supplier with a retail service obligation will see increased opportunities to access lower cost wholesale power. Even systems with surplus capacity

may be able to capture economic benefits associated with a continuing supply of low-cost short-term energy. Those utilities experiencing load growth requiring additional resources in the near term will also be able to take advantage of the benefits of the availability of lower-cost alternatives deliverable under open-access. Adequate time needs to be allowed for the beneficial effects of this open-access regime on bulk power costs to occur, be documented, and be evaluated in the context, among others, of the impact on end-use prices. At that time, a better understanding of the incremental value of retail competition can be obtained.

An obvious disadvantage of the new open-access regime is the ability of wholesale customers to replace their existing power supply arrangements to the extent consistent with the term and termination provisions of their existing contracts. Hence, any system with significant quantities of wholesale power sales under short-duration contracts could lose load (or experience reduced revenues by matching market rates).

Order No. 888 provides short-term market opportunities with a phased long-term approach to full competition, which phasing contemplates recovery of stranded costs under certain conditions. In effect, the bulk power marketplace would respond over time to new power supply options created by open access as systems secure new capacity resources to serve load growth and to replace retired facilities or terminated purchase power contracts.

Retail access is not covered by the open-access rules under Order No. 888. Municipalization presently is the only means of taking advantage of open-access under the Order, but the Order makes clear that state commissions retain jurisdiction with regard to such municipalizations, unless they fail to address stranded cost recovery, at which point jurisdiction would revert to FERC. The state commissions retain sole jurisdiction over retail wheeling where state authority permits.

The effects of Order No. 888 are uncertain, however, for a number of reasons. The full implementation of the rule is to occur July 9, 1996, when affected utilities make their open-access transmission filings. The contents of the rule are subject to change as a result of numerous requests for rehearing and clarification of the Order. Also, the potential for a court challenge seeking to alter the rule or have it declared illegal is possible. Hence, the fate of Order No. 888 is uncertain until the routine challenges run their course. Assuming no injunctive relief is granted, transactions will begin under this new regime in mid-summer.

At the federal level, there have been numerous discussions of possible federal legislation to address sweeping industry restructuring changes, including federally mandated retail competition and the relative roles of state and federal regulatory agencies. The consensus seems to be that no such legislation is likely this year, but could come to the forefront next year. Obviously, such legislative initiatives could impact Arizona initiatives. If the Commission continues its more deliberate investigative process, it likely will have the benefit of reacting to any federal legislation which could impact Arizona as well as all other states.

B. State Initiatives. The status of state initiatives on retail competition and industry restructuring is literally changing daily. Attached is a brief synopsis of state-by-state activities. As can be seen from this brief summary, some states have not yet begun (e.g., Mississippi), others have preliminarily considered and rejected retail wheeling (e.g., North Carolina and South Carolina), still others are preparing studies and conducting experiments (e.g., Michigan and Illinois), and a few are actively pursuing full retail competition by a date certain (e.g., California and Massachusetts). Obviously, there is no consensus path among the states. For the most part, however, the trend seems

to be to move cautiously in understanding the effects of any transition from regulation to competition, including retail wheeling and industry restructuring.

The greatest proactive initiatives are found in California and Massachusetts, where the utilities in both states are perceived as having substantially higher costs than competitive alternatives. Each state is operating under directives to implement full retail competition: Massachusetts by 1998; and California by phase-in over five years commencing in 1998. A distinguishing feature of the California initiative is the interim step of creating an independent system operator ("ISO") for the transmission facilities of the existing utilities and a regional power exchange by 1998. This would precede the 5-year transition to full retail competition starting in 1998. Massachusetts, on the other hand, has not mandated a state-wide solution. In fact, it is experimenting with retail wheeling to gain a better understanding of the advantages and disadvantages and any impediments to implementation on a full-scale basis.

The California and Massachusetts "experiments" are but two responses out of fifty to regulatory change. They are by far the most aggressive responses of any to date. A separate task force could be formed simply to monitor and study these major restructuring initiatives. AEPCO has not attempted to address them in detail, but merely observes that they offer two more sources of information to incorporate in the Commission's database as it deliberates how to address retail competition and industry restructuring in Arizona.

C. **State-Federal Issues.** There continues to be a potential jurisdictional dichotomy between the FERC and individual state regulatory commissions emanating from the matter of transmission access. This dichotomy manifests itself in several specific ways. Under the EPAct and Order No. 888, the FERC has the authority to order transmitting utilities and public utilities,

respectively, to enlarge their transmission systems to provide transmission access where adequate transfer capability is not available. The FERC, however, does not have siting and certification authority for transmission facilities; rather, this authority in most instances rests with state regulatory agencies as it does in Arizona. As open-access transmission develops under Order No. 888, state commissions will face tough issues regarding siting and certification of new transmission facilities to accommodate purely open access wholesale transactions along with the corollary issues of cost responsibility and pricing as those additions might affect traditional retail jurisdictional business.

Order No. 888 also leaves less than clear the division of responsibility with regard to what facilities are FERC jurisdictional and what facilities are state jurisdictional in addressing transmission access where retail wheeling occurs. The FERC makes clear that if unbundled retail transmission in interstate commerce occurs voluntarily by a public utility or as a result of a state retail access program, the FERC has exclusive jurisdiction over the rates, terms, and conditions of such transmission. What is indeterminant is which facilities constitute transmission as opposed to state-jurisdictional local distribution facilities. This will be determined on a case-by-case basis applying seven functional/technical tests adopted under Order No. 888. The legal implications of this determination are significant; the administration of this state-federal jurisdictional split becomes complex; and the interaction of the affected jurisdictions in resolving disputes is far from clear.

If the Commission were to order retail wheeling, thereby functionally unbundling production, transmission and distribution services, it would immediately find itself faced with these issues created by Order No. 888 with regard to retail access in interstate commerce. While the FERC rejected any "bright line" test of jurisdictional separation of facilities, it seems logical, as part of any

restructuring, to consider jurisdictional separation decisions and how such separations will be administered in conjunction with expansion of the transmission system to serve retail and wholesale loads. Until such a critical issue is analyzed thoroughly, it seems illogical to proceed with full-scale retail competition or restructuring initiatives because of substantial uncertainties with regard to the economic impact on all affected parties. Once again, AEPCO sees this as yet another area requiring more definitive development before any global plan could be rationally considered for adoption and subsequently implemented.

VI. INSTITUTIONAL ISSUES REGARDING RETAIL COMPETITION/RESTRUCTURING

A. **Legal Issues in General.** One of the tasks of the Working Group on Retail Electric Competition was to identify legal issues related to retail competition in Arizona. The Final Report of the Working Group on Retail Electric Competition ("Phase I Report") simply lists in summary fashion broad categories of legal issues inherent in pursuing retail wheeling. Unfortunately, in the need to summarize, the list presented in the Phase I Report over-simplified, without discussion, the detailed list of fundamental issues developed by the attorney task force subgroup of the regulatory task force. Further the Phase I Report also simply notes that the legal issues will be developed in future activities in this ongoing investigative docket.

At this point, AEPCO does not consider any of the legal issues thus far identified as absolute barriers to retail competition or restructuring. This position, however, is based solely upon a very preliminary review of those legal issues and some of the initial comments received by the attorney task force. Whether any of these legal issues ultimately present insurmountable barriers can only be determined by thorough legal analysis of each of those issues. Until such analyses are prepared and determinations are made as to which legal issues, if any, require action (legislative, regulatory

or constitutional amendment) to remove impediments to competition, it is difficult to perceive how the Commission could knowledgeably evaluate whether to proceed with implementation (either with limited pilot programs or full-scale retail competition). Without such in-depth analysis of these many legal issues, there is uncertainty as to whether the admittedly broad constitutional authority of the Commission is sufficient without, for example, constitutional amendment or legislative action, to successfully pursue retail competition should it determine that action to be in the public interest.

In addition to the broad questions of legal authority and jurisdiction to implement retail competition and restructuring, there are a number of specific legal issues which relate directly to the ability to implement retail competition and restructuring in a manner that does not competitively disadvantage certain entities and groups of customers. Section V.B, below, discusses in detail a unique concern of AEPCO and its member systems.

B. Unique Cooperative Legal Issues. As described in detail earlier, AEPCO, its distribution system member-owners, and their retail customers enjoy a unique relationship partially created through RUS financing and wholesale power contracts which support that financing. The distribution system members also enjoy beneficial RUS financing which is highly dependent upon the economic viability of those systems and their ability to service that debt obligation. Without these beneficial financing arrangements, AEPCO and its members would experience increased costs which would, in turn, increase their rates, thereby making them less competitive and more likely to lose load. This issue alone is of paramount concern to these systems.

The system of interdependent contracts which make RUS financing possible must not be disturbed. Recognizing the sanctity of those contracts alone is not sufficient, however, to protect

AEPCO and its members from severe, adverse consequences of retail competition because of the particular characteristics of these systems, particularly their service area and customer composition.

AEPCO's six distribution members serve separate areas which are primarily rural in nature. These systems have extremely low density (i.e., consumers per mile of line) compared to investor-owned and municipal systems which serve more densely populated and economically attractive areas.⁴ In fact, it is well accepted that cooperatives were developed originally to serve areas which did not enjoy central station electric service, in part because existing suppliers considered it economically unattractive to serve these less desirable areas. That is the reason AEPCO was formed by its member distribution cooperatives.

While AEPCO and its members have successfully strived to produce and deliver power as efficiently and inexpensively as possible, it is axiomatic that it is more costly to serve more rural, less dense areas. Likewise, it is more costly to serve some of the more commonplace loads in these areas such as small, sparse, low load factor irrigation loads which dot the service areas of these systems.

Notwithstanding the generally rural nature of these systems, several of AEPCO's members have seen growth in their service areas result in the development of some higher than average density areas with a better balance of loads (i.e., a mix of residential, commercial and small industrial customers). These service areas, however, still do not compare with the more attractive high density areas served by neighboring competitors. Several of the distribution cooperatives have also been fortunate to serve a few large mining loads and other large commercial/industrial loads.

⁴For example, Duncan Valley has but 4.8 meters per mile, while Sulphur Springs, even with populated Sierra Vista, has only 10.3 meters per mile.

The largest of these is Phelps Dodge at Morenci. The Morenci Phelps Dodge load served by Duncan Valley and AEPCO is approximately 200 MW while the remainder of Duncan Valley's load is only 4.4 MW. Phelps Dodge alone constitutes approximately 40% of AEPCO's annual coincident peak load.

While such large loads have brought needed diversity to AEPCO and its members, they are not without risk. The loss of one or more of these large loads to retail competition without adequate protective mechanisms and time to build bridges to mitigate the loss would be devastating to AEPCO and its members. This gets to the crux of the potential adverse effects which might occur if the RUS financing system, based on the contractual relationships between AEPCO and its members, and the reasonable expectations inherent to the certificated service areas of those members are undermined by retail competition.

As described in Section IV, above, so-called retail competition may simply become a means for "cherry picking" or "cream skimming" by alternative suppliers focusing on the more attractive (i.e., large) loads and more desirable (i.e., higher density, better load factor) pockets of service area. If this type of opportunism were allowed to develop as part of retail competition, the effects on AEPCO and its members are self-evident. First, these systems already are competitively disadvantaged simply by the nature of their service areas and loads. If they were subjected to the loss of the few areas and loads which provide badly needed diversity, the cost to serve the remaining member customers would increase due to stranded investment, deterioration in density and load factor, and other effects, especially since such members have no shareholders to help shoulder the burden. Second, as rates increase for the remaining member customers under this scenario, additional fringe area loads would then become more attractive for cream skimming, thus

perpetuating a downward spiral. And third, the whole fabric which holds the cooperatives together as a viable segment of the industry serving rural Arizona is undermined, threatening RUS financing, which if lost would further intensify the situation.

AEPCO asks that the Commission recognize the unique nature of the relationship between AEPCO, its distribution members, and their customer members, and that this relationship is held together by contracts which must remain inviolate and is underpinned by certificated service areas, all of which makes lower cost financing available. AEPCO submits that the sanctity of these member-owner contracts and federal pre-emption also support retention of this unique relationship. In addition, the loss of selected customers in certificated service areas may constitute the loss of a vested right or property interest (i.e., a "taking" which is compensatory over and above any considerations for stranded investment and negative impacts on the remnant system).

A final point needs to be made regarding this unique financing and service relationship. AEPCO and its members are currently proscribed from securing beneficial RUS financing to serve non-act beneficiaries under the REAct, as amended. Furthermore, as long as RUS financing is in place, any alternative financing for competitive reasons would be subject to RUS lien accommodations, which create encumbrances that are not without cost in the financial marketplace. Although this is not an insurmountable legal issue, it directly relates to how retail competition, if imposed upon AEPCO and its members, would affect the contractual relationships discussed in detail above.

VII. RETAIL COMPETITION/RESTRUCTURING FOR ARIZONA

A. **Should Arizona Proceed?** AEPCO believes the first question the Commission should ask is whether there is a real problem in Arizona that requires an immediate fix. Absent an

existing or impending problem, AEPCO suggests that the public interest will be best served by further study, data gathering, and implementation of voluntary single-utility based pilot programs, if justified, before a final decision is made to go forward with retail competition and, if so, what restructuring, if any, is required.

Arizona is not suffering from the same extremely high costs of power faced by ratepayers in California, the Northeast, and other pockets around the country. If viewed in isolation, there is no doubt that Arizona consumers, especially large industrial users, could lower their costs by taking advantage of the current economic environment where the short-run marginal cost of capacity and energy is less than the average embedded cost upon which current rates are based. This opportunity, while attractive, should not compel an immediate shift by the Commission to retail competition solely to benefit these users, potentially at the expense of the remaining ratepayers. Such cost shifting is problematic to any system losing customers to retail competition, but it would be potentially devastating to AEPCO's members' rural consumers, especially residential consumers. The particular dangers to AEPCO and its members are described in Section V.B, above.

Large industrials, currently the greatest potential beneficiaries of retail competition initiatives across the country, want regulatory commissions to perceive an immediate need for full-scale retail competition. These entities are proponents of competition, because this is the environment in which their goods and services are marketed. They are perceived in the industry, though, as being less concerned about retail competition as a concept to benefit all and more interested in their opportunity to immediately lower power costs, even if it means shifting a portion of the costs which have been incurred on their behalf to other ratepayers that are less capable, or incapable, of taking advantage of retail competition.

AEPCO submits that the Commission should not be persuaded to act precipitously at the urging of this, or any other, narrow, self-interest constituency. In fact, utilities in Arizona, with the concurrence of the Commission, have undertaken innovative arrangements to meet the needs of new and expanding industrial loads within the state through flexible contracts. For example, AEPCO and Mohave Electric were instrumental in attracting North Star Steel with an innovative real time pricing-buy through contract to meet the needs of the customer, with the net result being attractive industrial development within the state. AEPCO and Duncan Valley also have entered into supplemental arrangements with Phelps Dodge to offer real time blocks of power from other, lower cost generation sources in addition to AEPCO's existing facilities. Again, this type of flexible contractual arrangement allows the current utility supplier to take advantage of lower-cost power market opportunities for the benefit of desirable loads without the potentially detrimental effects of open-season retail competition.

AEPCO believes that many of the benefits of retail competition are achievable for those best positioned to take advantage of that competition through flexible contracts (including buy-through real-time purchases), performance based rate making, voluntary single-utility-based "pilot" programs, and other innovative measures which do not require a major overhaul of existing statutes, regulations, and existing structural relationships upon which both utilities and ratepayers in Arizona now rely. Such innovative arrangements should be carefully evaluated to determine whether they effectively can capture economic benefits of retail competition under the current industry structure while avoiding the potential adverse effects of restructuring (e.g., cost shifting, consumer dislocation, and other inequities) inherent in sweeping structural change. AEPCO believes that such programs are a low-risk way to gather hard data which is badly needed to supplement theoretical

competition concepts. Such measures could also provide an opportunity to focus on specific impediments to competition in general and the ability of specific consumers to meaningfully participate in alternative power supply opportunities. Specifically, a voluntary single-utility-based pilot program might be used to determine what is operationally feasible: how to meter, to bill, to market various services. AEPCO, for example, continues to be concerned that the cost and technological viability of metering and communications systems are such that in the immediate future, small customers, especially residential users, may be severely limited in their ability to access alternative power suppliers, even through aggregation of multiple small users' loads.

B. How to Proceed? For all the reasons discussed above, AEPCO concludes that: (1) no compelling circumstances have been documented which justify immediate departure from the existing structure of the electric industry in Arizona; and (2) the public interest would be best served by reserving judgment on retail competition and restructuring while the Commission continues to study relevant issues and assess the actions and experiences of others' initiatives. This approach would also permit the full effects of the FERC's implementation of its open-access transmission policy pursuant to Order No. 888 to develop within the wholesale bulk power market, with the concomitant opportunity to assess the beneficial effects on Arizona ratepayers of such wholesale competition which also benefits retail customers.

AEPCO recommends that the Commission resist embracing theoretical competition rhetoric in favor of accepting well-documented analyses which demonstrate that competition is in the public interest in Arizona and can be implemented equitably and without unduly adversely affecting any sector (supplier or purchaser). The Commission should encourage affected parties voluntarily to present empirical studies in support of any recommended transition to retail competition, whether

or not accompanied by restructuring. Similarly, the Commission may find it useful to conduct such studies on its own.

Until sufficient cause exists to justify specific actions (either mandated pilot programs or full-scale retail competition), the Commission should continue to allow regulated systems to individually and voluntarily conduct pilot programs which examine the implementation and effectiveness of retail competition and alternative forms of customer service which might capture the effects of competition within the electric industry without restructuring. If the Commission ultimately determines that it is in the public interest to effect retail competition through restructuring, AEPCO still recommends that full-scale implementation be preceded by successful pilot programs designed to test the effects of specific proposed restructuring initiatives on the various affected constituencies.

This cautious approach may defer somewhat any decision to implement restructuring, if determined to be in the public interest. While this may result in some short-term, foregone economic opportunities, the trade-off is a greatly improved ability to implement change and manage transition without multiple iterations and the attendant mistakes associated with hasty action. A correct decision with sustainable long-term benefits is far preferable to a quick fix accompanied by short-term benefits for some but not all affected parties and a lower probability of sustainable long-term benefits for all without further modifications. One is reminded of the Basuto (African) proverb: "If a man does away with his traditional way of living and throws away his good customs, he had better first make certain that he has something of value to replace them."⁵

⁵Ruark, Robert; Something of Value; Doubleday (1955).

Finally, AEPCO recommends that the Commission issue a notice of proposed rulemaking for comment with regard to any mandated pilot programs to solicit the widest possible input to specific initiatives proposed for implementation. Similarly, if the Commission ultimately determines it is in the public interest to implement retail competition in industry restructuring, this should be achieved through formal rulemaking and evidentiary proceedings to permit affected parties to address the specific proposed initiatives. Broad investigative proceedings such as those thus far initiated by the Commission elicit such a wide spectrum of responses that it is good policy to synthesize these responses and other available information into specific recommendations for comment by the public prior to any policy change by the Commission.

VIII. PRINCIPLES OF RETAIL COMPETITION/RESTRUCTURING

Although AEPCO is not recommending implementation of retail competition and/or restructuring at this time for all the reasons explained above, it still perceives the need for the Commission to establish a set of principles upon which to measure others' efforts and which will guide the analysis, deliberation, and any implementation of retail competition and industry restructuring in Arizona. These principles, which should be applied to pilot programs as well, would provide a framework that is in the public interest and not simply advantageous to narrow sectors (either purchasers or sellers) in the industry. Such principles should provide for an orderly transition from a regulated environment to a competitive environment with full recognition of the historical regulatory compact under which utilities took on an obligation to serve all customers in a given area in return for a right to serve that area and end-users who are committed to purchase power consistent with a certificate of convenience and necessity.

The objectives articulated by the Commission in its request for comments are laudatory, but they are imbued with the notion that there will be tradeoffs under any course of action adopted by the Commission. For example, several of the objectives talk about the need to "limit" the potential for certain effects (e.g., harm to the utilities and utility-investors and decreases in electric system reliability). AEPCO is in general agreement with these objectives, recognizes and accepts that there must be some tradeoffs, but advocates certain core principles which should be embodied in any reformation in the structure of utility services and the delivery and purchase of those services by end-users in Arizona. Such core principles should include, at a minimum, the following concepts:

- Contractual relationships must be maintained (including, but not limited to, utility/end-user contracts, G&T/distribution cooperative all-requirements contracts, financing contracts which might otherwise be impaired, and other existing contractual relationships upon which either the supplier or purchaser has reasonably relied as to an expectation of future sales or purchases of power in the retail sector);
- There will be recognition and full recovery of legitimate, prudently incurred and verifiable stranded costs from those users creating such stranded costs as a result of retail competition (including recognition that loss of retail load by distribution cooperatives may create recoverable stranded costs at the G&T supplier level);
- It is in the public interest to avoid unnecessary and uneconomic duplication of distribution facilities, and, therefore, local distribution suppliers should retain their vested property rights associated with certificates of convenience and necessity;

- Sham transactions to convert retail load to wholesale service to circumvent compliance with retail regulation (including retail competition and restructuring) will be rejected;
- Notwithstanding retail competition, the costs of renewable programs, demand-side management programs, and energy conservation programs mandated by the Commission through its integrated resource planning objectives should be borne equitably by all consumers who benefit from them, irrespective of their ability to secure alternative power supply arrangements;
- All societal costs associated with the transition from regulation to retail competition should be borne by consumers in accordance with their contribution to those costs (e.g., adverse environmental impacts as a result of retail competition should be borne by those creating such costs by accessing alternative power supply resources); and
- Any incremental costs attributable to the exercise of power supply alternatives as a result of retail competition should be borne by the beneficiary(ies) of the alternative power supply arrangements (e.g., if transmission and other facilities upgrades are required to reliably accommodate the import of power from alternative power suppliers, the user of the alternative power should be responsible for such associated costs).

The above minimum principles are proposed for the purpose of protecting the interest of existing suppliers and existing ratepayers and those ratepayers which continue to purchase from their traditional suppliers. These principles are also aimed at full recovery of all costs incurred on behalf of existing customers which seek alternative suppliers, so that the real costs of any shift in power

suppliers is not borne by those which are unable or elect not to participate in retail competition through selection of alternative power suppliers.

IX. UNIVERSAL SERVICE

The Rural Electrification Act was established in 1935 to extend electric service to the nation's rural areas where only a small fraction of the population had access to electric service. Congress and the president believed that electric service was essential, not only to the rural populace but also to the overall prosperity of the nation. Service had long been unavailable in these rural areas because the population density and characteristics of the electric loads made it uneconomical for investor-owned utilities to serve those areas, absent zonal pricing (as opposed to "postage stamp" rates) or average cost pricing. Each section of line had to show it could pay its own way before it was built -- leading to the construction of lines only to those affluent or profitable to the utility, while leaving others in the dark.

As rural electrification progressed, non-profit, cooperatively-owned systems such as AEPCO's members became the universal suppliers to most of these less economically viable areas. They looked at the revenue from the entire utility system to justify line extensions using revenue from the more profitable areas to help serve the less profitable. They called it the cooperative way. The goal was universal service, a reality today with service available to most of Arizona and the United States.

However, the original density and load characteristics in these rural areas have not significantly changed. Rural electric cooperatives, therefore, are both vulnerable and sensitive to the significant ramifications of restructuring the electric industry to induce retail competition. If service boundaries are removed, companies will choose to serve customers who provide the greatest

profit. As discussed in Sections IV and VI, above, the higher cost to serve rural areas makes the systems serving those areas vulnerable to "cherry picking" of those attractive loads (e.g., high load factor industrial loads) and service areas (e.g., more densely populated portions of a system). The loss of such attractive loads and service areas would simply lead to an even higher cost infrastructure for the remaining high cost areas.

It is not yet clear who will serve the remaining customers in those areas. One of the core questions the Commission must address is what obligation will remain with electricity providers to maintain service in the public interest. It appears that the Commission's workshop participants believe that the company operating the distribution wires and poles will somehow be responsible for ensuring adequate and reasonably priced service. If so, that leaves other questions concerning the affordability, quality and reliability of service that all customers should expect.

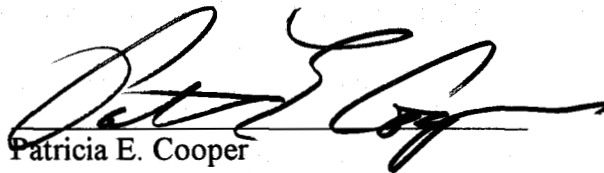
Ways to fund or subsidize such service to remaining rural customers should be examined. Resulting higher costs could be mitigated by the establishment of a universal service fund. The objective of such a fund would be to ensure that rural consumers continue to have access to essential electric service through their existing organizational structures on a basis that is competitive with the rates charged to other consumers in the more attractive, lower cost of service areas. Thus, the two goals of promoting competition and ensuring the continued provision of a basic necessity would be met. Competition should not mean that only those who have the money or live in densely populated areas get reliable firm power; a universal service program would make sure that it doesn't.

AEPCO supports the implementation of a universal service fund as an equitable means of establishing retail competition if retail competition is deemed necessary at all. Obviously, substantial details would have to be addressed as to how such a universal service fund would

function, including the establishment of basic service criteria and performance incentives and how monies would be collected and disbursed. The universal service fund concept has long been a part of the telecommunications industry, including the recently enacted 1996 Telecommunications Act. If the Commission decides to proceed with retail competition and restructuring of the electric industry, AEPCO requests that careful consideration be given to the universal service fund concept and that a task force be established to analyze the structure, implementation, and benefits of such a program.

These comments are respectfully submitted this 28th day of June, 1996,

By ARIZONA ELECTRIC POWER COOPERATIVE, INC.

A handwritten signature in black ink, appearing to read 'Patricia E. Cooper', is written over a horizontal line.

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Restructuring - Retail Wheeling

Date	State	General	Retail Wheeling
5/7/96	Alabama	House Bill 305, signed 5/6, allowing state to award stranded investment to power company.	Sunset provisions of HB 305 state that when Ala. or neighboring state initiates retail choice, law will expire in 5 years.
	Alaska		
3/11/96	Arizona	Comments due 6/28 on inquiry on restructuring proposals. After review, recommendation forwarded to Commission.	
1/12/96	Arkansas		Bill introduced in 1995, but withdrawn. PSC to consider in 1996.
6/14/96	California	Legislature has consolidated the myriad of restructuring bills and will hold comprehensive hearings in effort to pass final legislation. ISO and regional power exchanges by 1998.	December order of PUC: 5 year transition to full retail competition, start 1998, end 2003. Real Time and TOU rates
3/11/96	Colorado	Dereg. Bill 1234 withdrawn, defeated by Munis & Coops. Proposed study committee to report to legislature in 1997.	
2/26/96	Connecticut	Task Force set up in mid '95 to study issue. Interim report 2/96. Final to legislature 1/97.	
2/23/96	Delaware		Delmarva proposes to PSC that utility work with Commission to develop customer choice. Idea also filed in Md & Va.
3/22/96	Florida	Bill killed to study deregulation. Bill was to offer recommendations for legislation in 1997.	
12/29/95	Georgia	Nothing going on at PSC	Retail wheeling bill killed in committee.
	Hawaii		
6/14/97	Idaho	PUC held 2nd workshop on restructuring 3/19. Report to Legislature for 1997 session.	Washington Water Power filed experimental open access tariff allowing 30 customers to choose their supplier for part of their needs. Size of customer is from 1.3 to 20.6 MW and totals 15% of utility's load.
4/29/96	Illinois	Joint legislative committee offer recommendations by end of year.	Started 4/25 in Ill. Power area: 2 steel companies get retail power from Wisconsin Electric. Cilco's program to start 5/1 includes residential
12/29/95	Indiana	Ipalco' white paper' on restructuring. URC holding meetings on local competition.	PSI Energy plan to URC for alternative power sources for large customers, but PSI would take title to power and deliver to customer. URC still reviewing.

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Restructuring - Retail Wheeling

Date	State	General	Retail Wheeling
6/3/96	Iowa	Utilities Board adopts set of 10 principles to frame discussion on restructuring.	
4/29/96	Kansas		Bill signed by Governor, HB 2600 that places 3 year freeze on retail wheeling, while task force studies issue and 17 other restructuring issues. Report due 1/11/98.
	Kentucky		
1/29/96	Louisiana		New Orleans City Council holding inquiry into retail completion and other issues.
12/29/95	Maine	Legislation: 2 year, 2 stage restructuring study. Final report to Legislature by 1/97. PUC investigation, draft report by 7/19/96 with final report by 12/96.	
2/23/96	Maryland		PSC case 8678, comments 1/9. PSC final report rejected retail wheeling, saying relatively low rates meant MD. did not need "dramatic fixes". Delmarva proposes to PSC that utility work with Commission to develop customer choice. Idea also filed in De & Va.
5/6/96	Massachusetts	Restructuring plans filed by utilities 2/16/96. MIT awaiting State Supreme Court appeal on DPU decision for 75% stranded cost recovery.	Retail Competition 1/98. DPU issues 1st draft rule 5/96.
4/12/96	Michigan	Restructuring proposal from Jobs Commission report recommends: retail wheeling by 1/97, wholesale pool by 1998 with ISO and by 2001 full competition for all Commercial and Industrials.	PSC start retail wheeling for new C & I loads 1/97. Consumers and Detroit Edison file plans by 5/15/96. 2001 full competition for Commercial and Industrials.
12/29/95	Minnesota	PUC starts, 4/95, to investigate stating rates relatively low so Commission would take "cautious" approach. Comments due 1/96. Focus first on opening transmission and retail competition later. PUC believes stranded costs split between shareholders and customers. Report due late spring.	
	Mississippi		
	Missouri		
4/24/96	Montana	October 1995 PSC starts investigation. Hearings held in Jan-Feb Montana Power proposes splitting itself into services and supply units. Advocates 5 to 10 year transition to retail completion.	
	Nebraska		

Restructuring - Retail Wheeling

Date	State	General	Retail Wheeling
6/17/96	Nevada	Report and order of PSC indicates competition can benefit state if Legislature chooses. Rules must be flexible.	
6/3/96	New Hampshire	Final restructuring order of PUC by 1/6/97. Draft order by 8/6/96.	Legislature directs PUC to set up pilot program, starts 5/28. Law signed for full retail competition 1998. (HB 1392).
4/24/96	New Jersey	Nov. '94 BPU issues draft plan advocating increased competition in a cautious manner through an "evolutionary transition." New report due late spring. State utilities advocate a wholesale poolco through PJM.	
12/29/95	New Mexico		Industrials pushed retail phase-in bill by 2001 Bill failed.
5/20/96	New York	PSC decision: Restructuring plans filed by 10/1 containing statewide market exchange and ISO. Wholesale in 97, retail access in 98.	Bill introduced in legislature for retail completion by mid 1997. Orange & Rockland, 6/1, start retail wheeling pilot program.
2/9/96	North Carolina		Industrial group requests PSC investigate retail wheeling, E-100 Sub 74. After negative comments PSC decided not yet
5/8/96	North Dakota	Comments on restructuring issues due at PSC 5/1, meeting on 5/15.	
6/13/96	Ohio	PUC has series of roundtables on utility issues. Restructuring roundtable principles issued 6/6/96.	PUC allow large industrials to buy power outside their utility's service area. Proposed rules to allow retail aggregation. Retail competition bill in legislature, competition by 1/98.
6/11/96	Oklahoma	Broad NOI on restructuring by Corporation Commission, (PUD 960000145). Tech. meetings in June, July and Oct. Hearings set for Dec. 4th.	Senate bill for pilot program on retail wheeling. OG&E opposing vigorously.
	Oregon		
6/18/96	Pennsylvania	Report to Governor and Legislature due in June 1996. PUC Guidelines to be released in late June.	PUC Interim report rejects retail wheeling at this time. More hearings beginning of year. Three retail wheeling bills in legislature.
6/13/97	Rhode Island	House passes restructuring bill: 3 year stranded cost recovery at 2.8 cents/kWh, full retail competition in 1 year from July 97. PUC docket on collaborative principles; Company restructuring plans filed by 4/12/96.	
12/29/95	South Carolina		Industrials request retail wheeling docket. PUC turns down, Staff to carry out 'low-key' study.
	Tennessee		

Update: June 18, 1996

Restructuring - Retail Wheeling

Date	State	General	Retail Wheeling
5/8/96	Texas	Comparable access and pricing for wholesale use of ERCOT system. Unbundle transmission and generation functions of major utilities. Establish ISO for ERCOT. Report to 1997 legislature on stranded investment; 2nd report on competition	Next year big debate on retail wheeling.
	Utah		
4/24/96	Vermont	PSB restructuring inquiry from roundtable discussion in 1994; deadline extended to June 5th.	Governor pushing for retail wheeling
4/24/96	Virginia	PSC staff preparing report on retail competition due July 16th. Comments due September 16th.	Delmarva proposes to PSC that utility work with Commission to develop customer choice. Idea also filed in De & Md.
5/7/96	Washington	UTC hearings on charging exit fees. Competition docket in 1994, principles 8/95. Final guidelines (12/13): gradual introduction of retail choice and stranded investment. In 1996 hearings on practical steps to implement the principles	Washington Water Power filed experimental open access tariff allowing 30 customers to choose their supplier for part of their needs. Size of customer is from 1.3 to 20.6 MW and is 15% of utility's load.
	West Virginia		
5/8/96	Wisconsin	PSC decision 12/19 for retail competition by 2001 through a 32 step "building block" program. Plan also calls for ISO for equal access. Appropriate recovery of stranded costs. Order on ISO due in November.	
6/13/96	Wyoming	PSC sets up committees to study restructuring, with focus on retail wheeling White paper to be issued in August or Sept with either rulemaking or legislation to follow.	